

STATEMENT OF
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UNDER SECRETARY OF TRANSPORTATION FOR POLICY
DEPARTMENT OF TRANSPORTATION
BEFORE THE
SUBCOMMITTEE ON AVIATION
COMMITTEE ON COMMERCE, SCIENCE, AND
TRANSPORTATION
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Thank you, Mr. Chairman, Members of the Subcommittee. I am pleased to appear before you today in response to your invitation to review the status of DOT's rulemaking regarding "actual control" of U.S. air carriers. As you know, it is unusual for DOT to appear at a hearing concerning an ongoing rulemaking. Because we are still in the middle of the rulemaking process, having issued a supplemental notice of proposed rulemaking just last week, I cannot tell you what final decisions the Department is going to make because I don't know. We are all aware of the importance of this initiative, however, and we recognize the Committee's interest in it. For those reasons, I wanted to share, to the extent possible, the Department's thinking in proposing to refine the administrative policies that guide our citizenship reviews. Because the comment period for the SNPRM is open, I can only discuss general themes and policies in the rulemaking. I cannot address substantive issues or comments made to the Notice published last November or to the Supplemental Notice. But I will say that we carefully reviewed the comments we received, and considered them when drafting the Supplemental Notice, as we will do with any comments we receive in the next two months. Even though I must be relatively circumspect in my own comments here today, I will do my best to be responsive to you within those parameters.

With the publication of this Supplemental Notice, we are encouraging a thorough and broad-based debate. We chose to issue a Supplemental Notice because we have made substantive changes to our original proposal in response to comments and concerns expressed by interested parties, including other federal agencies and Members of Congress. We believe these changes will serve to clarify both our intent and the way the proposed rule would work in practice if we finally adopt it. We are interested in hearing people's reactions to those changes.

In the initial Notice published last November, we proposed that, under certain circumstances, DOT would move away from more than sixty years of administrative interpretation of the statute, allowing “no semblance of foreign control” in determining whether U.S. citizens were in control of U.S. airlines. That interpretation – not required by the words of the statute – has had the effect of relegating foreign investors to a largely passive role in any U.S. airline, unable to participate in the commercial decision-making affecting the value of their own investment. Despite occasional efforts to introduce some measure of flexibility, the policy has remained essentially intact.

What the Civil Aeronautics Board and DOT have always required – and what the statute now says explicitly after its 2003 amendment – is that U.S. airlines must be under the actual control of U.S. citizens. What the initial Notice proposed to do was to explore whether more foreign investment (within the numerical limits always allowed under the statute) could be encouraged if we, in applying the “actual control” requirement, adopted

a less forbidding, less categorical policy regarding the ability of foreign investors to participate in the commercial decision-making of U.S. airlines.

I want to emphasize that the only decision-making that would be affected by the proposal is commercial decision-making. Ultimate responsibility for management decisions relating to organizational documents, safety, security, and U.S. airlines' participation in Department of Defense programs – including CRAF – would be reserved to the U.S. citizen investors only.

The economic benefits at stake are substantial. Our proposal is primarily designed to enhance U.S. airline access to the global capital marketplace. Our proposal would have positive and long-term effects on the industry by expanding the pool of qualified investors, introducing new competition among investors to provide U.S. airlines with better terms, and enhancing strategic partnerships between U.S. and foreign airlines.

These changes could lower the cost of capital for U.S. airlines, which would be enormously beneficial for the U.S. industry as it restructures to meet the demands of the global marketplace. Additional investment opportunities in the airline industry can and will strengthen U.S. airlines.

This proposal does not envision a one-way street for investment, however. One of the proposal's most important provisions is a reciprocity requirement designed to encourage further liberalization of aviation markets and offer U.S. citizens opportunities to invest abroad in foreign airlines. Under the proposal, only foreign investors who are from

countries that have open-skies agreements with the United States and that permit similar investment opportunities for U.S. investors in their airlines would be eligible for this approach. I call this one of the proposal's most important provisions because it has the potential to encourage a more liberal approach to capital flows in aviation on a global basis. It would not only afford U.S. carriers the opportunity to tap more global sources of capital; but also under the reciprocity requirement, U.S. carriers, either alone or as part of a larger group of U.S. investors, would be able to enhance their international presence by investing in foreign carriers.

Thus, our proposal carries with it the prospect of far more liberal treatment of airline investments everywhere, resulting in more robust international alliances, a healthier and more efficient global airline industry, more competition for the benefit of travelers and shippers everywhere, and expanded job opportunities for airline employees.

At a February hearing conducted by the House Subcommittee on Aviation, opponents of the rulemaking testified that the proposal will relegate U.S. airlines to mere "feeder" status, and that the lucrative and prestigious long-haul international flights will migrate to the foreign investor airlines. In contrast to that fearful prediction, I have seen an investment banking report from Europe alleging that, by leaving untouched the statutory 75-percent minimum U.S. voting stock ownership requirement, our proposal is intentionally designed to ensure that U.S. carriers remain dominant players in the global airline industry.

I don't know whether U.S. carriers will dominate global aviation in the future, but we do believe that our proposal would, in fact, strengthen the U.S. airline industry without undermining any of our important national interests.

What we have done in the Supplemental Notice is to build upon and clarify the ideas we proposed in the initial Notice of Proposed Rulemaking. In light of the comments and concerns expressed about the NPRM, we consulted with other Executive Agencies, particularly the Departments of Homeland Security and Defense, as well as our own Federal Aviation Administration, to refine our proposal to better ensure not only that U.S. airlines remain under the actual control of U.S. citizens, but also that they remain safe, secure, and available to meet the nation's defense needs. The areas that would continue to be scrutinized for exclusive, non-delegable U.S. citizen control – safety, security, and national defense – would require DOT to strictly review the airline's structure, with particular focus on the carrier's fundamental organizational documents, which must also remain under exclusive U.S. citizen control.

In the Supplemental Notice, we have refined our previous proposal in part to make it clearer to airlines that might seek to benefit from our revised approach. Our proposal sets out two prerequisites to a foreign investor's eligibility to take advantage of this new interpretation: Does the foreign investor's home country have an open-skies agreement with the United States? If it does, then: Does the foreign investor's home country have a similarly open investment regime in its airlines for U.S. investors? Only if these two questions were answered in the affirmative would the Department commence a review of

the carrier under this new interpretation. If the answers are “Yes,” then the questions that would be examined are:

- Do the corporate documents – the charter, the by-laws, the basic agreements, etc. – reflect actual control by U.S. citizens of those documents?
- Is the foreign investor delegated any commercial decision-making authority?
- Is this authority ultimately revocable by the U.S. citizen majority owners?

To ensure full control by U.S. citizens of the carrier’s activities in three key areas:

- Are U.S. citizens clearly and completely in actual control of all decisions having to do with the carrier’s policies and implementation with respect to safety?
- Are U.S. citizens clearly and completely in actual control of all decisions and activities having to do with the carrier’s policies and implementation with respect to aviation security?
- Are U.S. citizens clearly and completely in actual control of all decisions having to do with Department of Defense programs?

And remember, the burden of proving all of these requirements would remain with the applicant. If the applicant could not meet that burden, it could not be licensed as a U.S. air carrier. Similarly, an already licensed carrier that received a significant offshore investment would be subjected to what we call a “continuing fitness review” including the same requirements and the same burden of proof. Failure to meet that burden would call into question the carrier’s continuing eligibility to hold an air carrier certificate.

While U.S. citizens will continue to exercise “actual control” of every U.S. airline, the only areas that could not be delegated to foreign investors would be these four – safety, security, national defense, and the carrier’s organizational documentation. Pursuant to arrangements with the U.S. citizen majority owners, foreign investors would be permitted to participate in the airline’s commercial decision-making in a more meaningful way.

I want to emphasize several points. First, the physical safety and security of every U.S. airline would be under the close supervision and control of the FAA, TSA, and other relevant authorities, as they have always been. CRAF carriers would also be subject to inspection by the military exactly as they are today. Second, the Department has a long history of closely examining carriers’ structure and operations to ensure that actual control remains in the hands of U.S. citizens; this function should actually be made easier by a narrower focus on the areas of corporate documents, safety, security, and defense activities for investments from citizens of qualified countries. Third, we think carriers that receive foreign investments as the result of the new rule, if we adopt it, are likely to be more careful than ever to ensure that all CRAF-related functions remain securely in U.S. hands, to avoid any question.

Under DOT’s proposal, U.S. citizens would have to continue to be in “actual control” of a U.S. airline for it to be eligible to retain its certificate. As the statute dictates – and we are in no way proposing to alter or change the statute – U.S. citizens would have to own 75-percent of the voting stock of the airline, would make up two-thirds of the Board of

Directors, and would include the president and two-thirds of the managing officers of the company. U.S. citizens would ultimately control the decision-making of the airline; any delegation of decision-making authority to the foreign investor would have to be revocable and could not be in the spheres of safety, security, national defense, or organizational documents.

In addition, we are not proposing any change in our criteria for ascertaining “control” for airlines not meeting the conditions for using the proposed interpretation and for those areas that we examine for airlines that do meet the conditions. The Advance Notice of Proposed Rulemaking published seven non-exclusive criteria that DOT’s Inspector General cited in his report as being generally used by the Department. We intend to continue to use those criteria.

The potential benefits of DOT’s proposal go well beyond enhancing the availability of capital to U.S. airlines. The international alliances that currently exist among U.S. and foreign airlines represent a surrogate for the kind of globalization that occurs around the world in other networked industries through conventional mergers and acquisitions. New opportunities for liberalized air services agreements bring competition home in the form of competitive prices to consumers and shippers.

I want to emphasize that we have proposed this interpretation because we believe it is justified on its own merits due to the potential benefits for the U.S. airline industry.

However, the European Commission and its 25 Member States have stated publicly that

the results of this rulemaking will be a factor in their decision whether to agree or not to a proposed first-phase U.S.-EU Air Services Agreement. Let me briefly address this Agreement, which is currently pending before the EU Transport Ministers.

The Agreement has the potential to fundamentally transform the framework for transatlantic air services, dramatically increasing the quality of competition in the market. It will benefit consumers and communities on both sides of the Atlantic, transcending anything we have yet achieved through our existing open-skies accords. The Agreement will also enhance the quality of transatlantic cooperation in the areas of safety and security, competition law and policy, and environmental and consumer protection. Moreover, the Agreement represents only a first stage of opening markets and enhancing cooperation.

Completion of the U.S.-EU Agreement would not only enhance airline competition across the Atlantic, but would also set a new standard for liberalization around the world. This Agreement will enable U.S. and European airlines – singly and in combination – to capitalize on the importance of a newly unified transatlantic market and develop a truly global presence. Success here can be expected to encourage emulation in other regions, accelerating the attainment of more open markets for international air services.

The globalization of the aviation industry has already begun; it's time that U.S. airlines are permitted to take advantage of the opportunities waiting for them.

Thank you for the opportunity to share the Department of Transportation's perspectives with you. I would be pleased to respond to your questions.